

**A NOTE ON THE ESTIMATION OF SOURCES
OF MUNICIPAL INVESTMENT FINANCING
IN THE CZECH REPUBLIC**

Prepared for:

**U.S. Agency for International Development
Municipal Finance Program**

by

**Zdena Matouskova
Urban Research**

May 1996

USAID Contract No. EUR-0034-C-00-2034-00
Local Government and Housing Privatization
USAID Project No. 180-0034
Urban Institute Project Nop. 06283-133-00

The Urban Institute
2100 M Street, NW
Washington, DC 20037

1.01 Municipal governments in the Czech Republic do not prepare separate capital budgets. Therefore, the sources of local investment financing must be estimated.

1.02 Investment expenditures are financed from revenues which we divide into three groups. The first group includes subsidies that the municipality obtains primarily from the Ministry of Finance and the Ministry of Agriculture, as well as subsidies from central extra-budgetary funds -- mainly from the State Environmental Fund. The second group includes debt -- commercial loans, revenues from municipal bonds, non-commercial loans, and zero-interest loans. These zero-interest loans are granted by the State Environmental Fund, or by the Ministry of Finance or the Ministry of Agriculture as a reimbursable financial assistance. The third group includes own financial means, i.e. budget surpluses either in the particular fiscal year or carried forward from previous years. Note that part of these local own-source revenues may be specifically "capital revenues" from the sale of property or other one-time events. However, we do not disaggregate the operating budget surplus.

1.03 Our analysis of financing investment construction makes certain assumptions:

- All the accepted loans and credits, regardless of their time structure, were used for financing the investment construction in the particular year.
- Reimbursable financial assistance is invested in the year it is received. The data used for working out the analysis were taken from the "Local Budgets' Statement", plus the information from the law on the state budget of the Czech Republic and from the state budget itself.
- Municipal bond proceeds are assumed to be invested in different years. We contacted each municipality to determine the time profile over which it spent its bond proceeds.
- Own resources were then calculated as a residual -- i.e., the amount not accounted for by the above specific sources of capital financing.

1.04 There are two types of subsidies granted to local budgets. The first type is the subsidies which are approved as a part of the state budget, the second types are subsidies granted in the course of the year. The "first" type of subsidies overview is shown in the following table.

Table 1
State Subsidies to Municipal Budgets

| | 1993 | | 1994 | | 1995 | |
|---|-----------------|--------------|-----------------|--------------|-------------------------------|--------------|
| | Kc(mill.) | % | Kc(mill.) | % | Kc(mill.) | % |
| Public Administration | 1,301.6 | 7.7 | 1,951.8 | 12.7 | 2,049.4 | 12.6 |
| Homes with Care Services | 985.8 | 5.8 | 1,506.0 | 9.8 | 1,688.0 | 10.4 |
| Social Benefits | 3,226.2 | 19.0 | 3,400.0 | 22.2 | 4,400.0 | 27.0 |
| Education | 840.6 | 4.9 | 1,493.9 | 9.7 | 1,500.2 | 9.2 |
| Social Care Homes for Handicapped Homes for Seniors | 701.0 | 4.1 | 2,495.3 | 16.3 | 2,671.9 1,023.1 1,648.8 | 16.4 |
| Equalizing Subsidy | 9,944.8 | 58.5 | 2,932.8 | 19.1 | 2,470.0 | 15.1 |
| Fire Protection | | 0.0 | 1,328.7 | 8.7 | 545.3 | 3.3 |
| Appointed Health Establishments | | 0.0 | 220.2 | 1.4 | 111.0 | 0.7 |
| Housing Construction | | 0.0 | | 0.0 | 520.0 | 3.2 |
| Selected Districts | | 0.0 | | 0.0 | 350.0 | 2.1 |
| Total | 17,000.0 | 100.0 | 15,328.7 | 100.0 | 16,305.8 | 100.0 |

1.05 The 1996 budget approved a total subsidy of Kc 16,848.2 million. The absolute decrease in subsidies in 1994 was 10% compared to the previous year. Between 1994 and 1995 the volume of subsidies increased at less than the inflation rate. The growth of subsidies in 1995 was 6.4%. In 1996 it is budgeted at only 3.3%. The annual inflation rate reached 9.1% in 1995, and for 1996 the Ministry of Finance estimates the inflation rate to be 8%. That means the real level of subsidy spending fell in all years.

1.06 From the total subsidy, the following subsidies are earmarked for investments: subsidies for homes with care services, subsidies for housing construction. The other subsidies are used for operating expenses of individual types of facilities, as indicated by the title of the subsidy. They are calculated as a certain amount per pupil, per bed, per administrative position and so forth. Since the subsidies do not cover the total operating costs connected with providing the particular services, it can be said that these revenues are not used to cover the costs of investment construction.

1.07 The local equalizing subsidy is granted to districts with a lower tax yield than the nationwide average. A certain portion of this type of subsidy will be presumably used for investment financing. It is really very difficult to estimate how big this portion will be, since the transfer is received as general revenue. Considering the development of this amount and the fact that in 1993 it reached up to 10 billion crowns and it represented almost 60% of the total volume of subsidies, we can presume that 50% of its yield in that year was used for investments and the other 50% for operational expenditures. However, this subsidy decreased sharply in 1994, and the volume of subsidy of 2,017.7 million crowns assessed for 1996 proves that this decrease still continues and that this subsidy is being partially replaced by other targeted subsidies. As for the analysis of the construction investment financing through 1994 - 1995 we will presume that only 20% of this subsidy's yield is used for investments.

1.08 A subsidy for selected needy districts was granted in all the observed years, however, it appeared as a part of the total subsidy only in 1995. In 1993 and 1994 it formed part of a subsidy granted in the course of the fiscal year. This subsidy is granted to districts with the most distressed environmental conditions. The districts themselves can decide whether they use the subsidy for environmental investment financing or for operating expenditures which would help reduce the consequences of environmental damage (contributions for children's recovery treatment and so forth). Considering that the people in areas with deteriorated environmental quality formerly received a certain financial compensation from the state, and that in the years 1993 and 1994 this subsidy was, in the chapter General Treasury Management of the state budget, included under non-investment expenditures, we'll presume for the year 1995 that the subsidy will be used for non-investment purposes.

1.09 We can make a partial conclusion that from the total subsidy in 1993 Kc 6 billion were used for investment construction financing, and in 1994 it was only Kc 2.1 billion. In 1995 it was roughly Kc 2.5 billion (see Table 2).

Table 2
Investment Portion of State Subsidies in Kc (mill.)

| Subsidies | 1993 | 1994 | 1995 |
|---------------------------|----------------|----------------|----------------|
| Houses with care services | 985.8 | 1,506.0 | 1,688.0 |
| Equalization subsidy | 4,972.4 | 586.6 | 494.0 |
| Housing Flat Construction | 0.0 | 0.0 | 350.0 |
| Total | 5,958.2 | 2,092.6 | 2,532.0 |

1.10 Besides the total subsidy which is approved within the state budget for the local budgets, there are a number of targeted reserves in the state budget. The drawdowns of these targeted reserves are decided in the course of the particular fiscal year. These subsidies are granted for concrete

purposes, i.e. both for investment projects and for operating expenditures. Subsidies for individually subsidized projects appear in the balance of the local budgets as 'Purpose' subsidies for investment construction, other subsidies under the item 'Purpose' financial means granted during the year. These financial means include both the investment and non-investment subsidies. Considering the fact that the structure of non-investment subsidies remains practically similar during the individual years, the investment part of this subsidy can be obtained as a differential item, i.e., by subtracting the operational subsidies from the total 'Purpose' financial means granted in the course of the year.

Table 3
State Purpose Means Provided within the Year to Municipal Budgets

| | 1993 | 1994 | 1995 |
|---|----------------|----------------|----------------|
| Total - from it: | 7,316.5 | 7,117.9 | 8,455.4 |
| Selected Districts | 700.0 | 700.0 | |
| Municipal Preservation of Ancient Monuments | | 275.0 | |
| Hospitalization on Social Grounds | | 320.0 | 68.0 |
| Means for Refugees | 400.0 | 400.0 | |
| Real Estate Adjustments | 200.0 | 800.0 | 800.0 |
| Non-investment Portion | 1,300.0 | 2,495.0 | 868.0 |
| Investment Portion | 6,016.5 | 4,622.9 | 7,587.4 |

1.11 During the individual years the percentage of investment subsidies from the purpose subsidies granted in the course of the year, was very different. In 1993 it was 82%, in 1994 only 65%, and in 1995 the share of non-investment subsidies increased to almost 90%.

1.12 Based on these partial results we can say that the subsidies earmarked for investments increased considerably in 1995 after their absolute decrease in 1994. In 1995 they went up by 19% compared to 1993, and compared to 1994 even by 31%. This growth was caused by an expanded participation of the state in financing the completion of hospitals construction, basic schools, water-development projects, investments to the transport infrastructure and to the vehicles of the public city transportation and to flat construction. Part of these subsidies came from the National Property Fund.

Table 4
Investment Subsidies

| | 1993 | | 1994 | | 1995 | |
|-------------------------------------|-----------------|--------------|-----------------|--------------|-----------------|--------------|
| | Kc(mill.) | % | Kc(mill.) | % | Kc(mill.) | % |
| Investment Portion of State Subsidy | 5,958.2 | 38.0 | 2,092.6 | 14.7 | 2,532.0 | 13.3 |
| Investment Portion of Purpose Means | 6,016.5 | 38.4 | 4,622.9 | 32.4 | 7,587.4 | 39.8 |
| Purpose Investment Subsidies | 3,688.6 | 23.5 | 5,822.8 | 40.8 | 6,337.3 | 33.2 |
| Transfers from State Funds | 0.0 | 0.0 | 1,730.1 | 12.1 | 2,609.4 | 13.7 |
| Total | 15,663.3 | 100.0 | 14,268.4 | 100.0 | 19,066.1 | 100.0 |

1.13 The following table gives an overview of the debt financial means used for investment construction. The data show that municipalities use debt financing of investment construction to a larger extent. During the two years the debt financial means grew by more than four times. The share of interest-free loans , i.e., the returnable financial assistance constantly slowly increased during the two years. In 1993 it represented 27%, in 1994 27.7% and in 1995 the share of non-commercial loans increased to 28.2%.

Table 5
Debt Means Used for Investments

| | 1993 | 1994 | 1995 |
|------------------------------|----------------|----------------|-----------------|
| Commercial Credits and Loans | 2,131.0 | 3,528.2 | 6,032.5 |
| Municipal Bonds | 28.5 | 1,965.1 | 3,123.6 |
| Zero-interest Loans | 800.0 | 2,100.0 | 3,600.0 |
| Total | 2,959.5 | 7,593.3 | 12,756.1 |

1.14 The share of budget surpluses in financing investment construction can be obtained as a difference between the total investment expenditures in the individual years and the so far identified sources, i.e. the total sum of subsidies and debt means. The following table shows how in 1994 the absolute amount of own revenues used for financing investment expenditures almost doubled

compared to the previous year, and in 1995 these financial means almost reached the same amount as in 1994.

1.15 The share of individual types of revenues for financing the investment construction was changing in the particular years. The only distinct trend appears in the development of the share of the debt financial means for financing investment construction. Whether the increase of the share of investment subsidies for financing investment construction in 1995 was a rare phenomenon or vice versa, whether the 1994 situation was exceptional, is a question of the future development.

Table 6
Municipal Infrastructure Financing

| | 1993 | | 1994 | | 1995 | |
|------------------------|-----------|-------|-----------|-------|-----------|-------|
| | Kc(mill.) | % | Kc(mill.) | % | Kc(mill.) | % |
| Investment Expenditure | 31,619.9 | 100.0 | 42,404.6 | 100.0 | 50,861.6 | 100.0 |
| from it: Subsidies | 15,663.3 | 49.5 | 14,268.4 | 33.6 | 19,066.1 | 37.5 |
| Debt | 2,959.5 | 9.4 | 7,593.3 | 17.9 | 12,756.1 | 25.1 |
| Own | 12,997.1 | 41.1 | 20,542.9 | 48.4 | 19,039.4 | 37.4 |

1.16 The following table shows the share of commercial and non-commercial debt in financing the investment construction. There is a constant increase of the share of commercial loans, although the pace of the increase slowed down in the last year.

Table 7
The Share of Commercial and Non-commercial Debt in Municipal Infrastructure Financing

| | 1993 | | 1994 | | 1995 | |
|------------------------|-----------|-----|-----------|------|-----------|------|
| | Kc(mill.) | % | Kc(mill.) | % | Kc(mill.) | % |
| Commercial Debt | 2,159.5 | 6.8 | 5,493.3 | 13.0 | 9,156.1 | 18.0 |
| Non-commercial Debt | 800.0 | 2.5 | 2,100.0 | 5.0 | 3,600.0 | 7.1 |
| Investment Expenditure | 31,619.9 | | 42,404.6 | | 50,861.6 | |